

Central Intelligence Agency



Washington, D. C. 20505

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MEMORANDUM FOR: The Honorable Richard R. Burt
Assistant Secretary
Bureau of European Affairs
Department of State

SUBJECT : Comments on Europe's Economic Prospects:
Their Implications for US-European Relations

We appreciate the opportunity to comment on your Office's paper on Europe's economic problems. As you indicated in your note, our analysis of West European economic prospects is much the same as your staff's. I should point out, however, that we are less sanguine about Western Europe's ability to muddle through the remainder of the decade, and are more concerned about the consequences for the United States of poor economic performance in Europe. Attached are more detailed comments on these points. We did not directly address the paper's policy recommendations.



Robert M. Gates
Deputy Director for Intelligence

Attachment: As stated

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Duplicate of C05248069: RIP: Released most of
pages 2-7, previously denied

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Comments on Europe's Economic Prospects:
Their Implications for US-European Relations

We agree with the thrust of the paper. Unemployment in the region will remain high at least through the end of the decade, increasing the likelihood of strains in US-European relations over a variety of economic, political, and security issues. We would put somewhat more stress than the paper does, however, on the fundamental nature of the region's economic problems and on the detrimental impact that West European attempts to deal with these difficulties may have on US-West European relations. 25X1

Our own analysis supports the paper's position that escalating real wages and the increasing role of the government in the economy have been significant factors pushing up unemployment in Western Europe. We would emphasize, however, that these developments have generated fundamental changes in the operation of the West European economies -- changes that have taken years to evolve. Not only have real wages risen rapidly, but other labor costs have jumped as well. To employ a worker in Italy, for example, an employer pays almost as much in non-wage costs, such as social security contributions, as in direct wages. 25X1

These labor cost problems, plus other government-induced labor rigidities, have been instrumental in preventing Western Europe from moving its employment base away from declining traditional industries into high-growth areas -- a necessary

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process if the region is to bring unemployment down in the face of rapid labor force growth. Because large-scale industrial restructuring is a long-term process, even a successful restructuring effort will not improve the employment picture any time soon. We concur with the paper's observation that "the European reaction to economic stagnation is acceptance of the idea that there is relatively little to be done about it." Given this resignation, we are not optimistic that labor rigidities will soon be relaxed or that real labor costs will be contained. Without such changes, finding the investment necessary to reorient the economy will be difficult at best. Moreover, government support for declining industries is continuing to give the wrong set of signals to the private sector.

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We also agree with the implications portion of the paper, but we would put even more emphasis on the potential detrimental impact that high West European unemployment may have on US-West European relations. We completely concur with the premise that high unemployment will lead West Europeans to increase protectionism, promote trade with the Soviet Bloc, limit defense spending, and intensify intra-European political and security cooperation. The paper, however, refers to these potential developments as future "irritants" in US-West European relations. We believe these issues could become major problem areas. Indeed, Western Europe may require a stronger US policy

focus rather than "less of a claim on our attention" as proposed by the paper.

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We are particularly concerned about the potential political/security problems which may be engendered by high unemployment. The region's economic malaise certainly is no cause for "apocalyptic language" in assessing implications, but we question the notion implied by the paper that the unemployed will sit by with "sad acquiescence" as during the Great Depression -- perhaps a poor analogy considering that the Depression fueled Communist and far-right extremist movements throughout Europe, including Nazism in Germany. Numerous polls in the region show that the economic situation is the major determinant of voting behavior. As a result, high unemployment is making incumbency a disadvantage in many national elections. Economic problems are the main political threat to northern European governments -- most of which are in general agreement with the United States on defense and East-West issues. The opposition socialist parties which could replace current governments in West Germany and the United Kingdom, however, do not support some key US security policies and objectives. While these parties might change their economic policies once in power -- as has the Mitterrand government -- we think it improbable their security policies would shift as dramatically to our liking.

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We also believe that the paper does not sufficiently draw out the negative consequences for NATO of the economic problems facing Western Europe. Our analysis supports the contention that poor economic prospects and continuing voter pressure for social welfare programs will lead our NATO allies to contain the real annual growth in defense expenditures to 2 percent or less for the remainder of the decade. We also agree that recent moves by the West European allies to seek closer defense cooperation, such as France's initiative to revitalize the West European Union, are not likely to be accompanied by increased defense spending. In the attempt to obtain more of an employment return for the same defense expenditure, moreover, the West Europeans are apt to drive a harder bargain with Washington in regard to the two-way street, burdensharing, international arms sales, and related issues. Some West European governments already are voicing suspicion that US moves to tighten up access to militarily significant technology are intended as much to preserve US commercial advantage in high-technology goods -- a sector West Europeans hope will provide increased employment opportunities. While we agree that none of this implies Western Europe will opt out of NATO, we believe the paper's reassurances to this effect leave the reader with too optimistic a picture of the problems facing the Alliance.

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Little or no growth in defense spending would result in a slowdown in NATO conventional force modernization, a decline in

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NATO readiness due to curtailed training and operations, and an increasing gap between the capabilities of the Warsaw Pact and the NATO Allies. These factors present the US with two equally unpalatable alternatives: either increase our own expenditures for the defense of Europe, or face a serious weakening of the Alliance's effectiveness as a deterrent.

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Implications for US-European Relations

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